

SOUTH COAST AIR QUALITY MANAGEMENT DISTRICT
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Preliminary Draft Staff Report

**Proposed Amended Rule 1302 – Definitions, and
Proposed Amended Rule 1309.1 – Priority Reserve**

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EXECUTIVE SUMMARY

While new electrical generating facilities (EGFs) have steadily been coming on-line since 2001, the prospect of electrical power shortages in Southern California and the Basin in particular continues. Factors contributing to potential shortages in the South Coast include increasing power demand, the retirement of some older EGFs and limitations of the power grid system in allowing the transfer of power from northern California to southern California. Siting of approximately 2,500 megawatts (MW) of new electrical power generation has been proposed in the Basin and in downwind air basins. Projects have also been proposed that are of regional significance, such as the LNG terminal and the construction of other energy-related projects in the ports. These projects are essential for maintaining the economic soundness of the region even as growth continues to place severe potential demands on the region's increasing energy needs. Increasing demand is also being placed on waste management in the region as processing options become more constrained with limitations on landfills and reluctance in investing in riskier unproven solutions such as deep well injection and gasification. Private and public/private partnered biosolids projects are one solution proposed for addressing the waste management issue. All these proposed projects will require emissions offsets. At the same time there continues to be a shortage of emission reduction credits (ERCs), specifically SO_x, PM-10 and CO in the open market. Staff proposes that the Rule 1309.1 be amended to provide a limited time window for electrical generating and regionally significant projects to utilize credits from the Priority Reserve, provided they demonstrate that the required offsets are not reasonably available in the open market. These projects and non-public biosolids processing facilities would pay a mitigation fee and adhere to certain other requirements of the rule, including a 1.2 to 1.0 offset ratio, in order to have access to offsets from the Priority Reserve.

Electrical generating projects in downwind basins would be provided an opportunity to purchase VOC credits for use in siting these facilities. VOC credits obtained from the Priority Reserve for downwind basin projects, subject to certain conditions, may be utilized to offset other criteria pollutant emissions by use of the inter-pollutant credit trading mechanism. Existing state law provides for the inter-basin transfer of credits and Proposed Amended Rule 1309.1 would incorporate state law requirements into this inter-basin use of Priority Reserve credits.

Staff is proposing that the definition of essential public service be clarified in Rule 1302 – Definitions. A limited exception is provided for publicly owned waste treatment facilities. An amendment to Rule 1302 will make explicit that biosolids processing at publicly owned facilities are essential public services. Staff is also moving the definition of EGF from Rule 1309.1 to Rule 1302.

BACKGROUND

Rule 1302 – Definitions

Rule 1302 defines terms and phrases used in Regulation XIII (including Rule 1309.1).

The proposed amendment will resolve the current ambiguity concerning the definition of an essential public service regarding biosolids processing facilities and clarify how these facilities will be permitted, move the definition of an EGF to Rule 1302 from Rule 1309.1 and clarify that facilities/sources qualifying as essential public services include publicly owned biosolids processing facilities. Definitions, for Energy Projects of Regional Significance (EPRS), Biosolids and Biosolids Processing Facility will be added.

Rule 1309.1 – Priority Reserve

At the April 2001 Public Hearing, Rule 1309.1 – Priority Reserve was amended to allow EGFs temporary access to the Priority Reserve to obtain SO₂, CO and PM-10 credits. California had been experiencing a shortage of electricity for over a year with some Stage 3 shortages (power reserves of less than 1.5%) and rolling blackouts occurring in 2001, and the demand for offsets in the open market exceeded the available supply. To accommodate EGFs access to the Priority Reserve while maintaining reasonable reserves for other than EGF categories particularly essential public services, credits totaling 750 lb/day of SO₂ and 6,000 lb/day of CO were transferred into the Priority Reserve from the AQMD's New Source Review (NSR) account exclusively for EGF use. Access by EGFs was subject to certain criteria, including paying a non-refundable mitigation fee. Furthermore, the amendments established that the EO would be able to transfer up to 1,500 lb/day of PM-10 credits into the Priority Reserve from the NSR account after a public meeting. The provisions regarding the transfer and availability of credits to the Priority Reserve for use exclusively by EGFs expired on December 31, 2003. On December 31, 2003 all credits previously transferred into the Priority Reserve or reserved in the Priority Reserve for exclusive use by EGFs were either transferred or released back to the District's NSR account.

The California Energy Commission (CEC) permits all power projects rated at or above 50 megawatts. State regulations give sole permitting authority including local land use and environmental regulations to the CEC. The CEC does require that all power projects meet all air quality regulations. For the AQMD, the main regulation affecting the permitting of power projects is New Source Review (Regulations XIII and XX). NSR requires that all projects satisfy Best Available Control Technology (BACT), modeling, offset, and public notice requirements. One potentially problematic area for power projects in the South Coast Air Basin has been and continues to be obtaining adequate offsets.

In accordance with state law, all emission increases from new and modified facilities must be offset. Under District rules most facilities with a potential to emit of greater than 4 tons per year of SO_x or PM-10 or 10 tons per year of CO are required to provide external offsets. External offsets are almost always in the form of ERCs. ERCs are created through the shutdowns or over-control of processes. ERCs are only granted for that portion of emissions which exceed current AQMD BACT standards. The ERC generation procedures coupled with the fact that stationary sources are relatively small contributors to the Basin's SO_x, CO, and PM-10 inventory, have been limiting factors in generating significant amounts of ERCs.

In 2005, despite new EGF projects, California once again experienced some Stage 2 shortages (power reserves down to 5%) and the outlook for the foreseeable future is that demand for electrical power will continue to increase. The increase in demand is due to several factors including increased consumption and retirement of older EGFs. There are also limits on the amount of electrical power that can be imported into the southern California region from northern California and Arizona due to bottlenecks in transmission lines. New EGFs are needed in the local region. The proposed amendments once again provide new EGFs access to the Priority Reserve where these proposed projects either do not have or can not secure the needed offsets on the open market. The rule extends the types of projects that may qualify for access to the Priority Reserve based on specific criteria in the rule. Projects added are, EGFs Downwind of the District with a less severe non-attainment status and energy projects considered to be of regional significance. Major energy projects necessary for the economic vitality of the Los Angeles basin are being proposed to have access to the Priority Reserve. These projects are of such significance that they warrant special consideration to facilitate siting. Also, private and public/private partnered biosolids projects are essential to mitigating the growing issue of waste management in the Basin. Staff proposes that the Priority Reserve be used to facilitate these needed projects.

PROPOSED AMENDMENTS TO RULE 1302 – DEFINITIONS and RULE 1309.1 – PRIORITY RESERVE

The proposed amendments to the rules are designed to provide access to the Priority Reserve for certain projects that meet specific requirements and that cannot secure the needed offsets on the open market. Also, the amendment to clarify the definition of an essential public service and include definitions of biosolids, biosolids processing facility, an EGF and an EPRS. Specifically, the amendments are summarized as follows:

Proposed Amendments to 1302 – Definitions

1. The current definition of an EGF is moved for administrative purposes from Rule 1309.1 to Rule 1302. An EGF is a facility that generates electricity for its own use and is less than 10 Megawatts (MW); or for a facility within the Basin less than 50 Megawatts (MW) that generates not less than 30% of its electricity to pump water to maintain the integrity of the surface elevation of a municipality or significant portion thereof; or is a facility that generates electricity for distribution in the state grid system (net generator).
2. Biosolids are defined as the nutrient-rich organic material resulting from the treatment of sewage sludge that can be used as a soil fertilizer.
3. Biosolids Processing Facility means an operation that produces biosolids from raw materials generated exclusively in the Basin. To ensure that raw materials will not be imported for processing, the Permit to Construct and Operate will include conditions limiting the operation to the use of only those raw materials generated in the Basin. Biosolids processing facilities may be exclusively publicly owned and operated, private or a public/private partnership. However, different requirements apply for exclusively public operations.
4. Energy Projects of Regional Significance (EPRS) are defined as projects of regional impact to enhance the import supply for use in the District of crude oil or natural gas with a Wobbe Index of no more than 1360 and that are sized no less than 150,000 barrels per day per project or 250 million cubic feet of natural gas per day per project. Such regional projects will be limited to LNG and crude oil projects and that are also anticipated to increase the volume and flow of such products into the region appreciably, hence the minimum project size requirements. Electrical power generation is increasingly being achieved by the use of natural gas, which is largely imported into the region. It is anticipated that increasing the flow and volume of such products into the Basin will help alleviate any potential electrical power and other projected energy shortages and so serves the same goals as allowing EGFs access to the Priority Reserve.
5. Publicly owned and operated biosolids treatment facilities are explicitly added to the definition of an essential public service to clarify that these facilities are an essential alternative to other forms of waste disposal. This waste management approach is becoming increasingly popular as other alternatives such as landfills decline. This amendment addresses the issue that this form of waste management does constitute an essential public service and one that is anticipated to increase into the future. Biosolids processing taking place at sewage treatment facilities are already covered as sewage treatment facilities and are currently classified as

essential public services. Publicly owned and operated biosolids operations not located at sewage treatment facilities will have their Permit to Construct and Operate conditioned to ensure ownership and operation exclusively as a public agency. Facilities that cease to be exclusively publicly owned and operated and become private or public/private partnerships will require new permits. Private and public/private biosolids processing facilities may have access to Priority Reserve credits provided they meet the requirements including payment of mitigation fees and an offset ratio of 1.2 to 1.0.

Overview of Proposed Amendments to Rule 1309.1 – Priority Reserve

1. The reference to Sulfur Dioxide (SO₂) in the rule is more accurately amended to Sulfur Oxides (SO_x),
2. Currently the rule specifies that funding of the Priority Reserve shall be quarterly “or other schedule deemed practicable by the Executive Officer (EO) or designee”. Emphasis is provided by new language that this includes suspension by the EO of transfers from the Districts NSR account if the credits are not available, and resume when the EO determines sufficient credits are available for transfer from the District’s NSR account.
3. The following new source types that have filed a complete application in calendar years 2005, 2006, 2007 or 2008 are proposed as eligible for access to Priority Reserve:
 - a. Electrical Generating Facilities - which are currently a single category will be split into two new categories “in-Basin EGF” and “EGF in Downwind Air Basins”. Qualified in-Basin EGFs may only draw from available Priority Reserve SO_x, PM-10 and CO credits subject to paying the appropriate mitigation fee, a 1.2 to 1.0 offset ratio and complying with other requirements. In-Basin EGFs that submitted a complete Initial Application for Certification with the CEC or a complete permit application in calendar years 2000 through 2003 pay the mitigation fees in effect in the rule adopted May 3, 2002. In-Basin EGFs that submit a complete Initial Application for Certification or a complete application for a permit in calendar years 2005, 2006, 2007 or 2008 must pay mitigation fees of \$50,417, \$15,033 or \$12,000 per pound for PM-10, SO_x and CO respectively and the above mitigation fees are to be adjusted annually by the California Consumer Price Index for applications submitted in 2006, 2007 and 2008. Qualified EGFs in Downwind Air Basins may only draw from the available pool of Priority Reserve VOC credits and must meet California Health and Safety Code requirements for inter-basin trading.

- b. Energy Projects of Regional Significance (EPRS) - which are energy related projects that enhance the supply of natural gas or crude oil used in the Basin as defined in Rule 1302. Qualified EPRS may only draw from available Priority Reserve SO_x, PM-10 and CO credits subject to paying the appropriate mitigation fee, a 1.2 to 1.0 offset ratio, and complying with requirements. Energy projects located in the Coastal Waters adjacent to the AQMD that are subject to federal permitting requirements and meet all other requirements that an on-shore EPRS must meet will qualify to draw credits provided the applicant submits an application to the Executive Officer at the time applications are filed for federal permits.
4. The proposed amendments to Rule 1302 clarify that biosolids processing facilities that are exclusively publicly owned and operated are essential public services. Biosolids processing facilities may also be privately owned or operated or may be a public/private partnership. These non-public biosolids processing facilities may be eligible for Priority Reserve Credits. Qualifying non-public biosolids facilities may only draw from the available pool of Priority Reserve SO_x, PM-10 and CO credits subject to paying the appropriate mitigation fee, a 1.2 to 1.0 offset ratio, and complying with the same requirements as publicly owned and operated biosolids facilities. If a biosolids processing facility ceases to be exclusively publicly owned and operated and becomes a non-public facility, the applicant must provide offsets at a 1.2 to 1.0 ratio and pay the mitigation fee in effect at the time of conversion or surrender an equivalent amount of offset credits.
5. The provision requiring the transfer of Carbon Monoxide (CO) into the Priority Reserve account, for use exclusively by EGFs, on a one time basis is eliminated, however qualifying EGFs and EPRS may have access to available Priority Reserve CO credits. Access to CO credits similar to SO_x and PM-10 credits will be contingent on the availability of credits in the District's NSR account.
6. Rule 1309.1 as adopted on May 3, 2002 established specific requirements for EGFs in addition to the mitigation fees, and the 1.2 to 1.0 offset ratio of this proposal. Several of these additional requirements are also applicable in this proposal to both the in-Basin EGFs and the EPRS. These requirements include that the facility use BARCT for all existing sources emitting the same air contaminant at the facility, that all sources under common ownership within the AQMD are in compliance with AQMD requirements, the applicant conducts a due diligence effort for offsets prior to seeking Priority Reserve credits up to the point Priority Reserve credits are issued and the source is fully operational at rated capacity within three years of the latter of Permit to Construct issuance or initial California Energy Commission certification. The applicant may seek an extension of the three years from the AQMD Governing Board if it is demonstrated that the

extension is necessary due to circumstances beyond the reasonable control of the applicant.

7. Additional requirements in the May 3, 2002 version of Rule 1309.1 that apply exclusively to EGFs that are also to apply to EGFs in this proposal include that the EGFs enter into a long-term (at least one year) contract with the State of California to sell at least 50% of the portion of the power which it has generated using the Priority Reserve credits and provided the EO determines at the time of permitting, and based on consultation with State power agencies, that the state of California is entering into such long-term contracts and that a need for such contracts exists at the time of permitting, if the facility is a net generator (this subsection does not apply to municipal utilities or joint powers authorities). In addition, the in-Basin EGF that submitted complete permit applications in 2000 through 2003, must comply with all terms and conditions in any EO order, whether expired or not, relating to the EGFs access of Priority Reserve credits, whether such credits are used or not.
8. EGFs that filed a complete application prior to calendar year 2004 may access the Priority Reserve for CO, SO_x, and/or PM-10 credits as allowed when the December 6, 2002 amendment to Rule 1309.1 was in effect. In that amendment EGF projects were limited to a maximum combined total draw of 750 lbs/day for SO_x and 6,000 lbs/day for CO. In-Basin EGFs that filed a complete application in calendar year 2005 or filed in 2006, 2007 or 2008 may access the Priority Reserve for SO_x, PM-10, and CO credits to the extent they are available in the Priority Reserve subject to the set aside amounts reserved exclusively for essential public services.
9. Access to Priority Reserve credits for projects except EGFs in downwind air basins, shall be prioritized based on qualifying and then, on the earliest date that the permit to construct is to be issued. Access to the Priority Reserve for EGFs in downwind air basins is based on the date the written request to receive credits is received by the Executive Officer.
10. Based on imminent public health or safety needs regardless of date of application submitted, the EO, and not the Governing Board, may determine specific project priority. Previously the rule required the AQMD Governing Board to make this determination.
11. A set-aside total of 400 pounds per day of PM-10, 800 pounds per day of CO and 200 pounds per day of SO_x is exclusively reserved for use by essential public services each calendar year to ensure credits will be available.

12. The paragraph limiting EGFs to a total of 750 pounds per day of SO_x and 6000 pounds per day of CO has been deleted. Subject to the set-asides reserved for essential public services, in-Basin EGFs, applying in 2005 through 2008, may have access to PM-10, SO_x and CO credits to the extent they are available in the Priority Reserve.
13. The EO shall monitor the PM-10, CO and SO_x balances in the Priority Reserve and in the event the balance of PM-10, CO or SO_x is less than 500 pounds per day or there is a project that will reduce the credits to less than 500lbs/day the EO may transfer up to 1,500 pounds per day of PM-10, CO or SO_x to the Priority Reserve after it is determined the credits are available from the District's NSR account. A public hearing is not necessary for this transfer. The amounts to be transferred should be sufficient based upon past experience and projected demand.
14. Offset credits obtained from the Priority Reserve and used in the District may not be used to generate interpollutant credits.
15. The subdivision addressing California Health and Safety Code §42314.2 has been deleted since this provision is no longer applicable.
16. A new subdivision has been added addressing mitigation fees and these fees will be dependant upon the date the complete application is submitted and if it is an out of the Basin EGF. EGFs with complete applications filed in 2000, 2001, 2002 or 2003 will pay the mitigation fees in effect when Rule 1309.1 was amended in 2001, of \$25,000, \$8,900 or \$12,000 per pound per day of PM-10, SO_x and CO respectively. An in-Basin EGF or an EPRS that filed a complete Initial Application for Certification to the CEC or a complete permit application with the AQMD in Calendar years 2005, 2006, 2007 or 2008 and non-public biosolids processing facilities will pay mitigation fees of \$50,417, \$15,083 and \$12,000 per pound per day of PM-10, SO_x and CO respectively. The mitigation fee for an EGF in a downwind air basin is \$1,410 per pound per day of VOC. The proposed mitigation fees for PM-10 and SO_x are based on the weighted average cost of ERC transactions for calendar year 2005. The proposed mitigation fee for VOC is based on the weighted average of ERC transactions from 2002 through 2005 since that period is more representative of recent market events for that air contaminant. The weighted average was then adjusted by an additional 5 percent to recover the internal cost of additional administrative efforts. Because of the scarcity of CO credits, staff recommends maintaining the initial mitigation fee for CO at \$12,000 per pound per day as the most representative for all qualifying years. Furthermore, all the mitigation fee rates will be adjusted each year on July 1, by an amount equivalent to the change in the California Consumer Price Index for the previous calendar year, beginning in July 2007.

17. A refund of 80 percent of mitigation fees up to a maximum non-refundable amount of two million dollars (\$2,000,000) per project, where the project is cancelled for in-Basin EGFs and EPRS that filed complete permit applications for which credits were sought in 2005, 2006, 2007 or 2008, and non-public biosolids processing facilities may be granted under certain circumstances described below. This refund provision is a new provision that was not available under the 2002 amendment but has been incorporated into this amendment in response to the comments received that a project may not go through for legitimate reasons, beyond the control of the project proponent. The non-refundable portion of the mitigation fee is designed to provide, primarily, a disincentive to adversely impacting the availability of credits to legitimate projects by applying with projects that are not genuine. It is believed that the \$2,000,000 maximum is a sufficient deterrent. Potential projects include: retrofitting diesel powered school buses with particulate traps or oxidation catalysts (NO_x, VOC, PM-10), replacement of existing diesel school buses with new alternative-fueled school buses i.e. CNG engines (NO_x, PM-10), re-powering of off-road heavy-duty diesel equipment with new lower-emission diesel engines and with particulate traps (PM-10, NO_x), replacing portable diesel generators with micro-turbines (PM-10, NO_x), providing low-sulfur diesel fuel to local locomotives (SO_x, PM-10), expanding LNG refueling infrastructure (NO_x, PM-10, SO_x). Additional programs and projects designed to reduce emissions include: purchase of fuel cells and electrification usage with ships at the dock (all pollutants), retrofitting other diesel mobile sources with particulate traps or oxidation catalysts (PM-10, NO_x), conversion of other diesel engines to alternative fuels (PM-10, NO_x, SO_x), conversion of lawn and garden equipment to battery and electric operated (NO_x, PM-10, VOC, CO) and demonstration or deployment of new emission reducing technology. The 20 percent fee is required to discourage a cancellation of offsets reserved and to ensure that air quality improvement projects can be identified and developed prior to or as close as practicable to the operation of the EGF. By not assessing this fee, an unacceptable level of uncertainty is imposed that would inhibit these monies from being spent and thereby delay air quality improvement.

A refund is not authorized for EGFs that filed permit applications in 2000, 2001, 2002 or 2003 and EGFs in a downwind air basin. A refund also is not authorized for the purchase of excess Priority Reserve credits.

A written request for a refund explaining the reasons for the project cancellation must be submitted to the Executive Officer either prior to the issuance of the Permit to Construct or within one year from the purchase of the Priority Reserve credits, provided it is demonstrated the cancellation is beyond the reasonable control of the applicant and the Executive Officer receiving the written request within 30 days of the project cancellation.

The credits that are the subject of the refund will be returned to the District's NSR account.

CURRENT ESTIMATED DEMAND FOR OFFSETS

Estimated Emission Credits to be Withdrawn from Priority Reserve

	PM10 (lbs/day)	SOx (lbs/day)	VOC (lbs/day)	CO (lbs/day)	NOx (lbs/day)
In-Basin EGFs: (2000MW Projects)	3,585	365	--	8,203	---
Energy Projects	200	1,114	--	417	---
Out-of-Basin EGFs	--	--	< 5500	--	---
Biosolids projects (present to 2010)	40	--	904	207	41
Biosolids Projects (2010 to 2020)	22	--	491	113	22
TOTAL (before 2010)	3,825	1,479	6,404	8,827	41
TOTAL (after 2010)	22	--	491	113	22

(Source: Based on SCAQMD's Federal Offset Account-Ending Balance, Table 1; SCAQMD Governing Board Agenda Item 25, April 2, 2004)

CEQA ANALYSIS

AQMD staff has reviewed the proposed amended Rule 1309.1 pursuant to state CEQA Guidelines §15002 (k)(3) and an Initial Study (IS) was prepared, pursuant to CEQA Guidelines §15063, and along with the Notice of Preparation (NOP), pursuant to CEQA Guidelines §15082, circulated for a 30-day public review and comment period from February 16, 2006 to March 17, 2006. The IS/NOP concluded the proposed amendments could result in a potential significant adverse air quality impact if the mitigation fee collected to fund emission reduction projects is unable to produce emission reductions an amount equal to the amount of credits used by newly eligible projects. In addition, this potential shortfall of emission reductions is expected to exceed the AQMD's PM-10, SOx and CO daily operational significance thresholds. A Draft Environmental Assessment (EA) is currently being prepared to further analyze the adverse air quality impact from the proposed project, as well as from alternatives to the project. No other environmental topic area is considered to have an adverse impact as a result of the proposed project. Six

public comment letters were received on the IS/NOP and responses to the comment letters will be included in the Draft EA.

SOCIO-ECONOMIC IMPACTS

A socioeconomic analysis of the amendments to Rule 1309.1 will be performed. The socioeconomic impacts associated with the CEQA alternatives will also be analyzed. The socioeconomic report will be released no later than 30 days prior to the Board hearing.

AQMP AND LEGAL MANDATES

The California Health and Safety Code requires the AQMD to adopt an Air Quality Management Plan (AQMP) to meet state and federal ambient air quality standards in the South Coast Air Basin. In addition, the California Health and Safety Code requires that the AQMD adopt rules and regulations that carry out the objectives of the AQMP. While Proposed Amended Rule 1309.1 is not a control measure included in the AQMP, its requirements are consistent with the AQMP objectives.

RESOURCE IMPACTS

The proposed amendments are not anticipated to have a significant impact on staff resources.

COMMENTS AND RESPONSE TO COMMENTS

Comment: The “due diligence” provision should be eliminated or specify a cut-off or final due date. EGFs need to have certainty regarding the price and timing of offset purchases from the Priority Reserve. Also, in order to obtain California Energy Commission (CEC) approval EGFs must demonstrate that they have the required project offsets.

Response: EGFs and EPRS are required to demonstrate that they have conducted a due diligence by the earliest date practicable and up to the time the credits are purchased from the Priority Reserve. This is necessary to ensure the priority reserve is a “bank of last resort”. This does not preclude facilities from continuing to seek out a more cost-effective source of offsets up until the time the offsets for the project must be in place, however due to the potentially limited supply of offsets from the Priority Reserve and to maintain equity the offsets are made available on a first come first serve basis. It is staffs understanding also that the CEC which must license all power projects greater than 50 megawatts only requires that the anticipated source of credits be identified but that there is no requirement to have the credits on hand at the time an application is filed. They do need to provide the credits at the time CEC issues its approval of the license.

Comment: The requirement for EGFs or EPRS to be on-line within 3 years from the date of initial application is too aggressive.

Response: There are a limited number of Priority Reserve offset credits available. The goal of the proposed amendments allowing EGFs and EPRS access to the Priority Reserve for offsets is to expedite the construction and operation of new power generation or energy capacity as quickly as possible in order to mitigate the anticipated shortage of power in the near future. The three year term in the current rule is intended to promote new generation and other energy projects to come on line at the soonest possible date. The three year term does not commence by the initial permit application date but rather from the issuance of a Permit to Construct or an initial California Energy Commission certification, whichever is later. Furthermore, the applicant can seek an extension from the AQMD Governing Board beyond the initial three-year period, provided it is demonstrated to be necessary due to the circumstances beyond the reasonable control of the applicant.

Comment: In the event that the actual operating emissions from a EGF project are less than the expected emissions EGFs should be able to sell surplus offsets obtained from the Priority Reserve back to the Priority Reserve.

Response: The scarcity of available offsets and the potential commitment of mitigation fees to projects would not make a sell back of surplus credits feasible. Mitigation fees are used to fund emission reduction projects. To allow a refund for up to several years after the credits are purchased will require the AQMD to wait those same several years to fund emission reduction projects with the fees or risk providing a refund when the fees have already been spent on emission reduction projects. Neither option is acceptable. Furthermore, permits are issued for the potential to emit as opposed to actual equipment/facility emissions.

Comment: The state is not currently entering into long term contracts for the purchase of electrical power. This language should be removed from the rule. If not removed it should be clear the requirement applies only to net generates.

Response: The specific language in the rule reads “enters into a long-term (at least one year) contract with the State of California to sell at least 50% of the portion of the power which it has generated using the Priority Reserve credits and provided the EO determines at the time of permitting, and based on consultation with State power agencies, that the state of California is entering into such long-term contracts” and also only if “a need for such contracts exists at the time of permitting”. If the state is not entering into contracts or there is no need, the Executive Officer will not require a contract. However, the option should remain if the state does start to enter into such contracts in the future. The requirement applies only to net generators.

Comment: EGFs and EPRS will typically require much larger quantities of offsets as compared to other facilities. The mitigation fee charged to EGFs for offsets from the Priority Reserve should be set a price lower than that of privately traded ERCs sold in the open market.

Response: Staff has assessed various pricing mechanisms for setting the price of mitigation fee offsets. There must, however, be equity in the price paid by any facility accessing the Priority Reserve. Staff has determined that a sales weighted average price is a reasonable approach of establishing the mitigation fee level. In addition, the Priority Reserve mitigation fee is intended to encourage use of Priority Reserve offsets as a last resort. If other facilities have recently paid a higher price for ERCs obtained in the open market it would not be either equitable or a disincentive to open up access to

the Priority Reserve for EGFs at a mitigation fee discounted from market ERC prices.

Comment: WOBBE Index is not defined.

Response: A definition of WOBBE Index has been added to Rule 1302.

Comment: EPRS located in Southern California Coastal Waters or the Outer Continental Shelf Waters should be eligible for credits from the Priority Reserve.

Response: Projects in Coastal Waters are federally permitted sources. Such sources in these waters immediately adjacent to the AQMD boundaries are to be treated the same as similar on-shore facilities for access to the Priority Reserve provided they also submit an application to the AQMD. Language has been added to PR 1309.1 to clarify this.

Comment: Staff should confirm the quantity of credits made available to the priority reserve and that the amount of credits is sufficient for all requesting projects.

Response: Staff has identified the quantity of credits required for known potential projects and anticipates sufficient credits will be available for these and some unanticipated projects. Staff cannot guarantee that credits will be available for all unanticipated future projects. Accessibility to the Priority Reserve is contingent only to the extent the Executive Officer determines that sufficient credits are maintained in the District's NSR account.

Comment: Only certain EGF projects are required to file for certification from the CEC. It should be clear that Rule 1309.1 does not require such a filing if it is not required.

Response: Projects less than 50 megawatts do not require CEC certification. There is no requirement in PAR 1309.1 that requires such projects file for CEC certification nor was it staff's intent to require so.

Comment: The deadline for filing applications for EGFs and EPRS should be extended beyond 2007.

Response: There are a limited number of Priority Reserve credits available. The proposed amendments allowing EGF and EPRS projects access to the Priority Reserve and limitation on submittal is to promote construction and operation as quickly as possible in order to mitigate the anticipated energy shortage in

the near future. The power shortage has been projected to continue through 2010. PAR 1309.1 has been amended to extend the filing period through 2008. This would allow additional time for project submittal and still result in most projects coming on line by 2010. In addition staff will commit to language in the adopting resolution to monitor the status of project installation and report back to the Board if an extension of the 2008 date is appropriate.

Comment: EPRS, in-Basin EGFs and non-public biosolids processing facilities should not be required to purchase credits from the Priority Reserve at a 1.2 to 1.0 offset ratio.

Response: The 1.2 to 1.0 offset ratio for these privately owned and operated projects establishes equity with all other projects that must acquire offsets on the open market at 1.2 to 1.0 offset ratios. Besides, in demonstrating the equivalency of its NSR program to the Federal NSR requirements, AQMD is required to debit its NSR account an offset ratio of 1.2 to 1.0 for such sources.

Comment: For an EGF constructed at an existing source, clarify that the “existing sources” which must meet BARCT in order to access the Priority Reserve are limited to sources directly related to the production of electricity at the subject facility.

Response: The Priority Reserve is intended to be a “bank of last resort”. The BARCT retrofit requirement is intended to apply to all equipment or operations at the existing facility that emit the same air contaminants as those requested from the Priority Reserve, not just those directly related to the production of the electricity.

Comment: Clarify that the prohibition of credit transfer does not apply if the project is transferred to another location provided there is not a change of operator.

Response: Permits to Construct are not transferable from one location to another. The Permit to Construct at the old location would be cancelled and a new application for a Permit to Construct would be required for the new location. The project proponent may be eligible for a partial refund for purchased credits if the requirements for refund in PAR 1309.1 are met. The project for the new location would be placed in the Priority Reserve queue as indicated in PAR 1309.1.

Comment: Clarify that a change of operator or name change will not affect position of an application in the Priority Reserve queue.

Response: A name change will not affect the application for Permit to Construct and therefore will not affect position in the queue. A change of operation prior to issuance of a Permit to Construct and commencement of construction will result in cancellation of the application for a Permit to Construct. A new application will be required from the new operator. Position in the queue, except for EGFs in a downwind air basin, will be based upon the date the Permit to Construct is to be issued.

Comment: Clarify that submittal of additional applications for a project will not affect the position in the Priority Reserve queue of other previously submitted applications for the same project.

Response: Position in the Priority Reserve queue, except for EGFs in downwind air basins is based upon the date the Permit to Construct is to be issued. The position in the queue for the additional applications will be based upon the date their Permits to Construct are to be issued.

Comment: Projects located in downwind air basins should be eligible for access to the Priority Reserve.

Response: PAR 1309.1 allows limited access to VOC credits in downwind air basin under certain circumstances.

Comment: The required approval of the credit transfer by the SCAQMD for the joint power project with the cities of Victorville and Palmdale should occur simultaneously with the adoption of the amendments to Rules 1309.1 and 1302.

Response: The amendment to the rules and the transfer of credits to the downwind districts are two separate and distinct actions although the credit transfer is dependent upon the Board approval of the amendments to Rules 1302 and 1309.1. The suggestion for concurrent approval will be considered by staff, however it is the Governing Board that ultimately determines what and when items are to be placed on their Board meeting agendas. PAR 1309.1 also authorizes the delegation of the authority to the Executive Officer to transfer

the credits, if the Board so desires, but the Board has not delegated this authority.

Comment: The due diligence requirement should be eliminated for EGFs in downwind air basins or if not, limited to evaluating offset availability in the downwind air basin, not in the AQMD.

Response: The due diligence effort is intended to include a search for offsets of the same air contaminant in the air basin where the project is to be located. It is not intended to require a search for interpollutant or inter-basin offsets. Therefore the due diligence for an EGF in a downwind air basin is limited to evaluating offset availability in that same air basin. Due diligence is required to ensure the Priority Reserve remains a “bank of last resort”.

Comment: The 1.2 to 1.0 offset ratio should not apply to credits requested by an EGF in a downwind air basin. The quantity of credits required should be determined by the downwind air district.

Response: A provision to subdivision (c) of PAR 1309.1, has been added stating the offset ratio for a project in a downwind air basin is determined by the downwind air district.

Comment: Since the AQMD does not receive permit applications for EGFs in downwind air basins, the prioritization for these projects should be based upon the date the Executive Office receives the written request specified in PAR 1309.1 (b)(6)(e).

Response: Paragraph (e)(i) of PAR 1309.1 has been amended to reflect that prioritization for projects in downwind air basins is based upon receipt of the written request for credits in subparagraph (b)(6)(e). However, it should be noted that to qualify for access to the Priority Reserve, the applicant must certify to the Executive Officer that a complete application has been filed with the downwind basin district.

Comment: Clarify whether the 1000 tons per year of VOC credits for EGFs in downwind air basins is the maximum amount for the entire life of the program or the annual allocation for each year of the program.

Response: The 1000 tons per year of VOC credits for downwind air basins is the maximum amount for the entire life of the program.

Comment: The refund cancellation fee should be limited to a maximum of \$1,000,000 since this amount should be a sufficient deterrent for speculative projects.

Response: Although the non-refundable fee provides a disincentive to adversely affecting credit availability to legitimate projects by applying for projects that are not genuine, it also recovers the administrative costs incurred by the AQMD for the refund, including recovering funding for clean air projects approved and funded with mitigation fees. Based upon the magnitude of the proposed projects and the cost of credits the suggested limit amount may not be sufficient to recover a significant portion of the clean air project cost for a typical EGF project. However, a cap of two million dollars (\$2,000,000) could be sufficient and language has been added to reflect a cap of two million dollars (\$2,000,000).

Comment: The option of requesting a refund due to cancellation of a project prior to the issuance of the Permit to Construct is of little value since the purchase of Priority Reserve credits generally occurs at the time the Permit to Construct is issued. This language has been removed from the proposal.

Response: The applicant purchases the credits at the time the Permit to Construct is to be issued. However, there can be situations where an applicant opts to purchase credits before the Permit to Construct is issued and the applicant should have the option to seek a refund if the project and application is cancelled before the permit is issued.

Comment: The requirement for a project cancellation to be “due to circumstances that the Executive Officer determines is beyond the reasonable control” in order to receive a mitigation fee refund should be deleted since it is vague and may not cover all legitimate reasons for cancellations, such as bankruptcy. The refund discount is a sufficient deterrent to cancellation of a project for anything other than compelling reasons.

Response: Since the full costs for clean air projects approved and funded with mitigation fees may not be recovered in the event of a project cancellation it is incumbent upon the Executive Officer to ensure the project is cancelled for compelling reasons. Those reasons are specific to an individual case and complete list of circumstances and reasons cannot reasonably be included in rule text. There may be circumstances in which a project bankruptcy is beyond the reasonable control of the applicant.

Comment: Explain the meaning of the requirement that an EGF comply with all conditions of any Executive Order, expired or not, if it relates to access to the Priority Reserve whether credits are used or not.

Response: This is language retained from current rule that may apply to EGFs that filed applications from 2000 through 2003, when there were Executive Orders in effect that have since expired. Permits to Construct under those orders may include conditions subject to the orders that would remain applicable until the EGF is fully operational and a Permit to Operate is issued. Language has been added to PAR 1309.1 to clarify this provision applies only to complete applications filed from 2000 through 2003.

Comment: Non-essential public service biosolids processing facilities should also have access to the Priority Reserve.

Response: The proposal has been amended to clarify that all biosolids processing facilities are essential public services and the term non-essential public service biosolids processing facility has been removed from the proposal. The proposal now distinguishes between public and non-public facilities; that difference being the non-public facilities are to pay mitigation fees and are subject to the 1.2 to 1.0 offset ratio.

Comment: Privately owned biosolids processing facilities should have the same requirements in 1309.1 as public facilities.

Response: Just as EGFs and EPRS, including all those that are for profit operations are required to pay mitigation fees for Priority Reserve credits and be subject to a 1.2 to 1.0 offset ratio, so should for profit biosolids processing facilities. This provides a level playing field with other for profit facilities seeking credits from the Priority Reserve as well as those that must seek offsets in the open marketplace.

Comment: It should be clarified that non-essential public service biosolids facilities with a potential to emit of less than 4 tons per year do not have to access the priority reserve and should modifications cause an exceedance of that threshold, access to the priority reserve would be granted.

Response: No new or modified source, including biosolids processing facilities, with a potential to emit of less than 4 tons per year is required to provide offsets. The term non-essential public service biosolids processing facility has been

removed from the rule and replaced with the more descriptive term of non-public biosolids processing facility. Non-public facilities with a potential to emit greater than 4 tons per year may receive credits from the Priority Reserve provided they meet the requirements in PAR 1309.1, including payment of mitigation fees and a 1.2 to 1.0 offset ratio.

Comment: The terms “owner and operator” and “applicant” are used interchangeably.

Response: For clarity the proposal has been modified to use the term applicant throughout.

Comment: Rule 1309.1 establishes a set aside of PM10, CO, and SOx exclusively for essential public services. The set aside should also include VOC and NOx.

Response: The set aside of PM10, CO and SOx credits for essential public services was established to ensure that the additional demand for such credits by EGFs would not jeopardize the supply of credits for essential public service projects. However, since in-Basin EGFs and EPRS do not have access to Priority Reserve VOC and NOx credits, they do not adversely impact the supply, of such credits. EGFs in downwind air basins have access only to a specific limited amount of VOC credits. Therefore, a set aside specifically for essential public services for VOC and NOx is not necessary.

Comment: Is the CPI the best index to use to track the increase in cost of Priority Reserve Credits.

Response: The initial cost of credits is established by a weighed average of previous transactions and is adjusted annually by the CPI. Given the limited number of years of access to the Priority Reserve by EGFs and EPRS, this reflects an equitable pricing structure without the complexity of a strictly cost of previous transaction approach. Non-public biosolids processing facilities pay mitigation fees as well and do not have a term limit on access to the Priority Reserve. Staff will continue to monitor use of the Priority Reserve by these facilities and in the event the term is extended for EGFs and EPRS consider pricing mechanisms that ensure the Priority Reserve remains a “last resort” source of offset credits.

Comment: Rule 1309.1 should be amended to clarify how Priority Reserve credits are tracked.

Response: Staff is currently developing a credit tracking rule to be included in Regulation XIII. The tracking mechanism for Priority Reserve credits will be addressed by that rule development.

Comment: The requirement for providing all offsets available for essential public services should be clarified so that it applies to “internal” offsets. In addition, it should be clarified that “all existing sources” in the requirement for EGFs applies to the se sources at the same facility.

Response: Language has been added to make these clarifications.

Comment: In those instances where the Executive Officer must approve actions or proposals of the applicant, the basis or criteria for the decision should be included.

Response: Language has been added to identify the basis for this Executive Officer or Governing Board action.

Comment: Facilities should maintain records of all credits obtained from the Priority Reserve.

Response: Rule 1309.1 requires facilities to maintain their balance of Priority Reserve credits. In addition, the AQMD maintains records of all Priority Reserve transactions and balances. Additional record keeping is not necessary.

Comment: The Executive Officer maintains the balance of PM-10, CO and SO_x credits and transfers credits to the Priority Reserve if necessary. The frequency of monitoring and where the credits are transferred from should be clarified.

Response: The AQMD maintains a record of all Priority Reserve transactions and balances including the balance of the Priority Reserve. When the Priority Reserve balance for PM-10, CO or SO_x falls to less than 500 pounds per day, PAR 1309.1 language allows the Executive Officer to transfer credits to the Priority Reserve from the Districts NSR account if credits are available from the Districts HSR account.

DRAFT FINDINGS

Before adopting, amending or repealing a rule, the AQMD Governing Board shall make findings of necessity, authority, clarity, consistency, non-duplication, and reference, as defined in Health and Safety Code Section 40727. The draft findings are as follows:

Necessity – The AQMD Governing Board has determined that a need exists to amend Rule 1309.1 – Priority Reserve to allow electrical generating facilities, energy projects of regional significance and essential public services access to the Priority Reserve for offsets when they are not available on the open market, and establish equivalency with Federal Clean Air Act requirements for Federal Major sources and comply with state law. Furthermore, the AQMD Governing Board has determined that a need exists to amend Rule 1302 – Definitions to clarify the definition of essential public service and add new definitions.

Authority – The AQMD Governing Board obtains its authority to adopt, amend, or repeal rules and regulations from Sections 40000, 40001, 40440, 42300 (permit system), 40709.6 (inter-basin, inter-district offsets) and 40702 of the California Health and Safety Code.

Clarity – The AQMD Governing Board has determined that Rules 1302 – Definitions and 1309.1 – Priority Reserve, as proposed to be amended, are written or displayed so that their meaning can be easily understood by the persons directly affected.

Consistency – The AQMD Governing Board has determined that Rules 1302 – Definitions and 1309.1 – Priority Reserve, as proposed to be amended, are in harmony with, and not in conflict with or contradictory to, existing statutes, court decisions, or state or federal regulations.

Non-Duplication – The AQMD Governing Board has determined that Rules 1302 – Definitions and 1309.1 – Priority Reserve, as proposed to be amended, do not impose the same requirements as any existing state or federal regulation and are necessary and proper to execute the power and duties granted to, and imposed upon, the District.

Reference – The AQMD Governing Board, in amending the rule, references the following statutes which the AQMD hereby implements, interprets, or makes specific: Health and Safety Code Sections 42300, 40709.6, 40920.5, and CAA §§ 171, 172 and 182.

CONCLUSIONS AND RECOMMENDATIONS

Staff recommends amendment of Rules 1302 and 1309.1 for the reasons stated in this staff report.